Part I. FDI and Technology Transfer in Asia : 3. Investment Financing of Japanese Corporations: The Case of the Automobile Industry

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Investment Financing of Japanese Corporations: The Case of the Automobile Industry

Chie Kashiwabara

1. INTRODUCTION

Most analyses of the actual conditions of Japanese corporate finance carried out since the late 1970s, have focused on the relationship between a company and its main bank. In this paper, we will analyze the roles played by private banks, especially the top six city banks, in supporting the Japanese automobile industry to put domestic equipment investment into practice on a large scale, thereby increasing its international competitiveness, while expanding its business through foreign direct investment (FDI). The main consideration of this paper being: the infrastructure role played by city banks in the consolidation of the automobile industry.

One of the main characteristics of the automobile industry is the enormous scale of its capital demands. For example, an automobile company usually invests some hundred billion yen in a single FDI project in order to establish a production plant, compared with the billion yen required for a home-electronics or optical-instrument company's project. Indeed, the scale of automobile investment can be better understood when contrasted with the total yearly domestic investment for the whole general machinery industry which is equivalent to that of a single automobile maker.

Secondly, the generality of the automobile industry should be noted because it influences numerous related sectors. An automobile as a final product consist of sixteen to twenty thousand items. Therefore, its influence on the many supporting sectors – parts and components, sales/maintenance, material supplies, i.e., steel and plastics, etc., and related service sectors such as haulage and passenger transportation, should not be neglected. Given these circumstances, it is common for host countries, especially developing countries, to expect substantial spin-off effects – technology transfer, employment, etc. – when an automobile company decides to invest there. As the perceived importance to the economy as a whole and overall economic development is greatly anticipated.

The remainder of this paper will be organized as follows:

(ii) how the Japanese auto industry developed its business domestically and worldwide, and financed its investment from early stages to the present.

(iii) the role of city banks in the industry's corporate finance in relation to policy credits, capital markets, and branch expansion abroad.

(iv) probable schemes for Japanese banks' subsidiaries to participate in the process of a host country's industrial development are introduced.

(v) concluding remarks.

2. AN OUTLINE OF THE AUTOMOBILE INDUSTRY'S BUSINESS EXPANSION AND FDI

Under GHQ control, the Japanese automobile industry was permitted to produce trucks in 1945, and cars in 1947[1]. However not until after 1955, when the government embarked on a policy to promote a national car, did the real motorization-era begin, coming to maturity in the late 1960s. During this period, automakers started knock-down (KD) production in developing countries of Southeast Asia and Latin America, successfully coping with import substitution policies and local-content regulations. Let us observe how the Japanese automobile industry became competitive, and expanded abroad.

2.1. Investment Financing of Assembly Makers

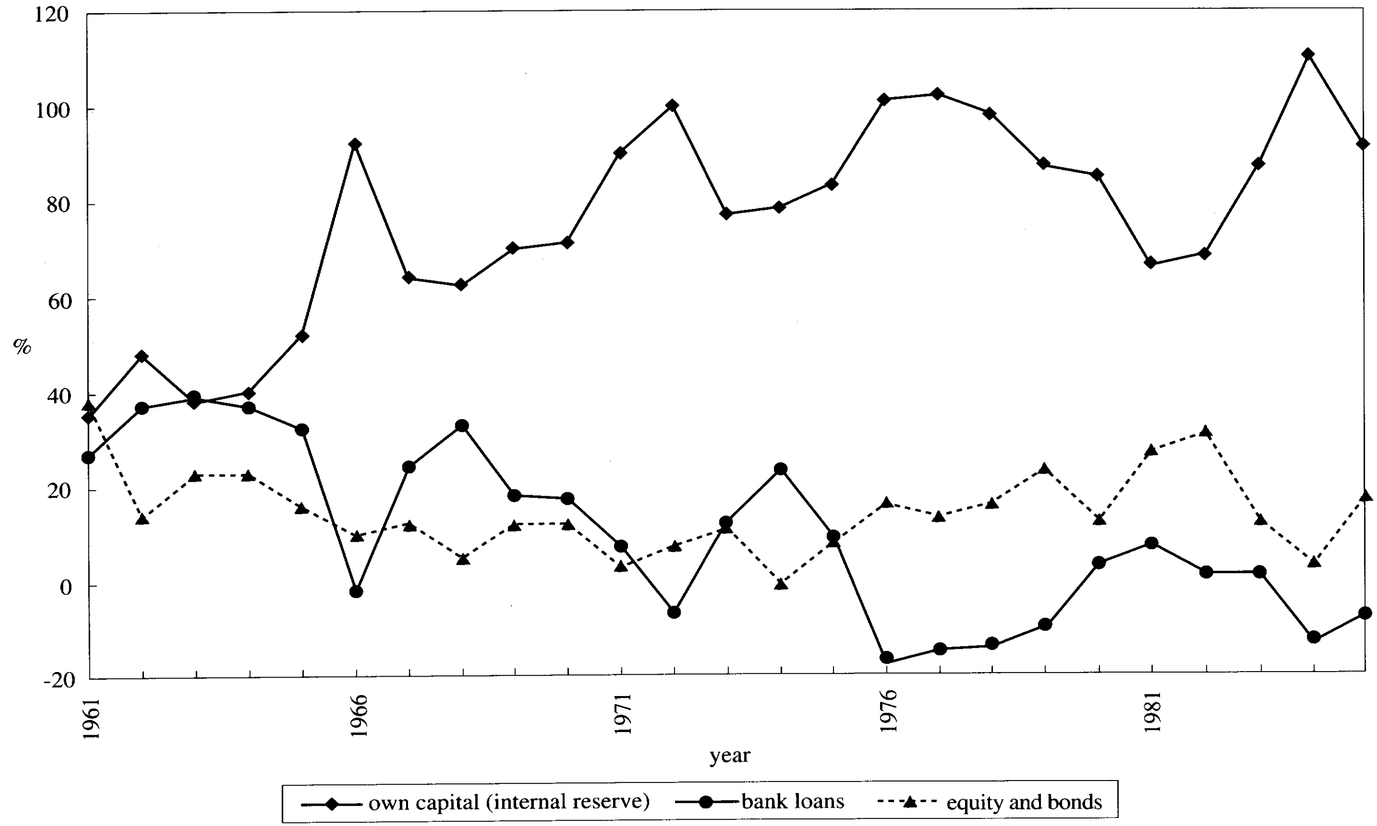
2.1.1. The Pre-Motorization Era

In the 1960s automakers carried out investment financing mainly through their internal reserve capital and bank loans, both accounting for approximately 30 to 40 percent of total credit demand, while their dependence on equity and corporate bonds hovered around 20 percent. However, as the motorization trend expanded in the late 1960s, the automakers broadened the share of internal reserve capital rapidly, reaching almost 100 percent in 1971. At the same time the ratio of financing from private banks became erratic thus restraining dependence on equity and bonds to around 10 percent (see Figure 3.1).

Among the main reasons why the automakers had been able to access such a large amount of bank loans in the early 1960s – pre-motorization era – was that a series of strong government policies and laws to promote the industry were promulgated. In 1956, a year after the national car promotion policy, the Temporary Measure Law for Promoting Machinery Industries was enacted – following initiatives of the Ministry of International Trade and Industry (MITI) – that aimed to encourage modernization of the machinery industries to promote production technology. According to the law, governmental financial organizations, such as the Japan Development Bank (JDB) and Japan Finance Corporation for Small Business (JFS), provided special credits to the automobile industry, the main sector of the machinery industry. These special loans also gave incentives to private financial organizations to increase outstanding balances to the industry. The automobile industry until the mid-1960s extended their business by means of vigorous equipment investment with outside capital, some of which were political loans based on industrial policy and credits from private banks. These credits were also utilized to enhance technological standards and establish footholds of enormous retained earnings (see Figure 3.2).

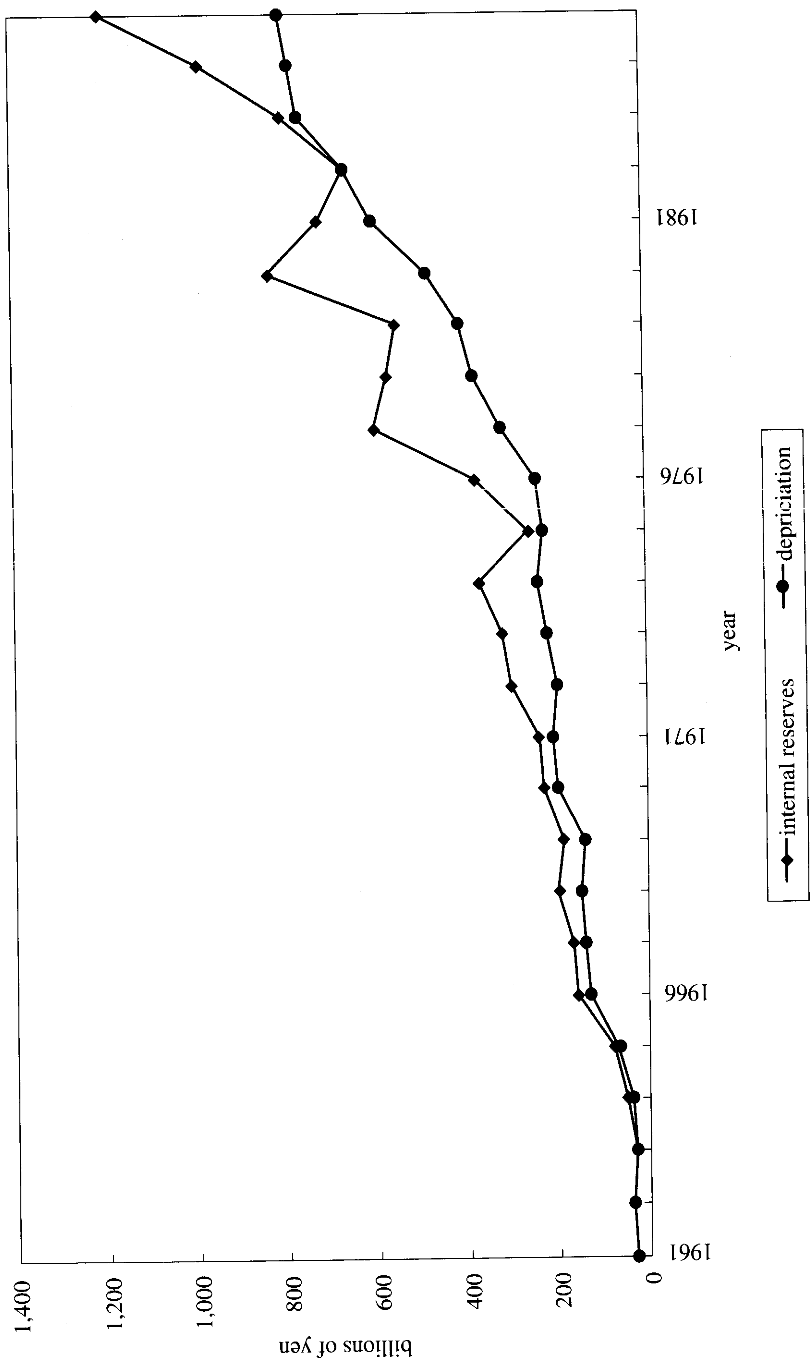
Supported by industrial policy, the automobile industry sped up equipment investment while preferential taxation incentives also played a crucial role. The Law for Promoting Corporate Rationalization, enacted in 1952, to rationalize machinery equipment and support capital accumulation, specifies sectors which were authorized to apply additional depreciation or special depreciation according to the Special Taxation Measurement Law. The automobile industry took full advantage of the law to accumulate internal reserve capital. Depreciation is a minus factor to profitability because it is appropriated in the category of deductible expenses, but as cash it does not flow outside of a company. Each automaker converted depreciation into internal reserve capital and agglomerated its retained earnings to strengthen its profit base, and, at the same time, supported equipment investment abroad using its internal

Figure 3.1: Investment Financing of Assembly Makers



Source: MITI. *Shuyo Sangyo no Setsubi Toshi Keikaku* (Investment Plans of Major Industries). various issues.

Figure 3.2: Amount of Internal Reserves and Depreciation of Assembly Makers



Source: JDB. *Kaigin Kigyo Zaimu Detabanku* (JDB Databank of Corporate Fianancial Affairs).

reserve capital (free from interest rate) to expand production, operating scale and competitiveness.

2.1.2. Enlargement of FDI

Automobile industry FDI in the 1960s and early 1970s was primarily utilized in Asian and Latin American countries to secure domestic market share and cope with host governments' import substitution policies. On the other hand, FDI with regard to the United States, Canada, and Europe was utilized to support exports of final products from Japan, the main investment within these countries being used to expand domestic sales networks to maintain their dealers and establish subsidiaries for import and sales as well as retail credit.

However, as trade friction with the US and Europe accelerated in the late 1970s, domestic production in those countries started, and at the beginning of the 1980s investment to eliminate trade friction was generalized. In addition to trade friction, throughout the 1980s other factors that influenced the Japanese automobile industry's rapid expansion of FDI are as follows: 1) the economic climate in Western developed countries was seen as prosperous, 2) parent companies in Japan had benefited from the prosperity in the domestic market, and 3) in consequence, the costs of raising funds on the Japanese financial markets had been remarkably lessened. The total amount of funding from the financial and security sectors was greatly boosted.

Under these conditions, big assemblers established large production plants in the US and shortly afterwards in Europe. These plants were accompanied by parts makers as joint investors, and/or adjacent subcontractors. For example, Nissan Motor Manufacturing Corporation (NMMC), established in Tennessee in 1980, had 19 subcontractors from Japan, both subsidiaries and joint ventures among parts makers, including non-member companies of Nissan's assemblers association.[2]

The financing of such large factories was carried out mainly through the use of internal reserves and from capital markets in Japan and abroad through both bond issuing and increase in capital stocks, as the ratios of bank loans in assemblers' investment demands was overtaken by issuing bonds in 1976, as seen in Figure 3.1.

Table 3.1: Financial Companies of Assembly Makers

As of the end of August, 1996

	country	name of company	year of establishment	capital stock	% of subscription*	other subscriptor	main contents of business
TOYOTA	USA	Toyota Motor Credit Corp.	1983	US$ 630m.		Toyota Motor Sales U.S.A. Inc. (TMS)(100%)	sales crediting
	Canada	Toyota Credit Canada Inc.	1990	Can.$60	100%		sales crediting
	Germany	Toyota Credit Bank	1988	DM55m.		Toyota Deutschland GmbH	sales crediting
	UK	Toyota Motor Finance (UK)	1988	£3m.	100%		collecting financial information
	Netherlands	Toyota Motor Finance	1987	FLS 2m.	100%		financing foreign related companies
	Australia	Toyota Finance Australia Ltd.	1982	A$ 80m.	100%		sales crediting
NISSAN	USA	Nissan Motor Acceptance Corp.	1981	US$500m.		Nissan Motor Corp. in U.S.A.	retail/wholesale crediting, leasing
	USA	Nissan Finance of America, Inc.	1988	US$ 5m.		Nissan Motor Corp. in U.S.A.	employing/raising funds in the USA
	USA	Nissan Capital of America, Inc.	1990	US$ 1m.		Nissan Motor Corp. in U.S.A. (100%)	founing/lending to group companies in the USA
	Canada	Nissan Canada Finance, Inc.	1990	Can$23		Nissan Canada Inc. (100%)	retail crediting, leasing
	UK	Nissan International Finance	1987	US$10m.	100%		employing/raising funds in Europe
	Netherlands	Nissan Finance, B.V.	1987	FLS0.5m.		Nissan Europe N.V. (100%)	retail/wholesale crediting, leasing
	Netherlands	Nissan International Finance (Netherlands) B.V.	1987	FLS 8m.		Nissan Europe N.V. (100%)	fonding/lending to European subsidiaries
	Germany	Nissan Band GmbH	1989	DM180		Nissan Motor Deutschland	retail/wholesale crediting, leasing
	Spain	Nissan Financiacion, S.A.	1983	Pta 4.8b.	9.9%	Nissan Motor Espana S.A.	retail/wholesale crediting, leasing
	Italy	Nissan Finanziaria S.p.A.	1993	Lit 2b.		Nissan Italia S.p.A. (100%)	retail crediting
	Australia	Nissan Finance Corp. Ltd.	1974	A$ 13m.	76.65%	Nissan Motor Co. (Australia)	retail/wholesale crediting, leasing
MITSUBISHI	USA	Mitsubishi Motors Credit of America, Inc.	1991	US$15m.		Mitsubishi Motor Sales of America Inc. (100%)	sales crediting
	Netherlands	Mitsubishi Motors Europe B.V.	1989	FLS6.7m.	100%		managing European companies
HONDA	USA	American Honda Finance	1980	US$266m.		American Honda Motor Co.,	financing to Honda dealers
	Canada	Honda Canada Finance, Inc.	1987	Can.$60m.		American Honda Finance	sales crediting
	Netherlands	Honda International Finance B.V.	1984	FLS 0.3m.	100%		employing/raising funds inside Honda group
FUJI	USA	Subaru Acceptance Corp.	1991	US$ 2m.		Subaru of America, Inc.	sales crediting in the USA

Note: *Percentage figures show those of subscription by the parent company in Japan.
Source: Extracted from Nikkan Jidosha Shimbunsha [1997], *Jidosha Sangyo Handbook 1997*, p. 130–149.

2.1.3. New strategies for fund raising

As the scale and the capital amount of FDI expanded, each corporation had to establish and strengthen its in-house system or grouping for capital funding as assembly makers established subsidiaries to operate sales finance in the US and Europe in the early 1980s. Later in the decade, the biggest enterprises like Toyota, Nissan, and Honda, established subsidiaries which managed internal loans to foreign correlative companies, and collected financial information. Furthermore, they divided subsidiaries and subscript companies spread worldwide into several groups, and a specialized financial subsidiary was established in each branch to operate fund raising and management within the group.[3]

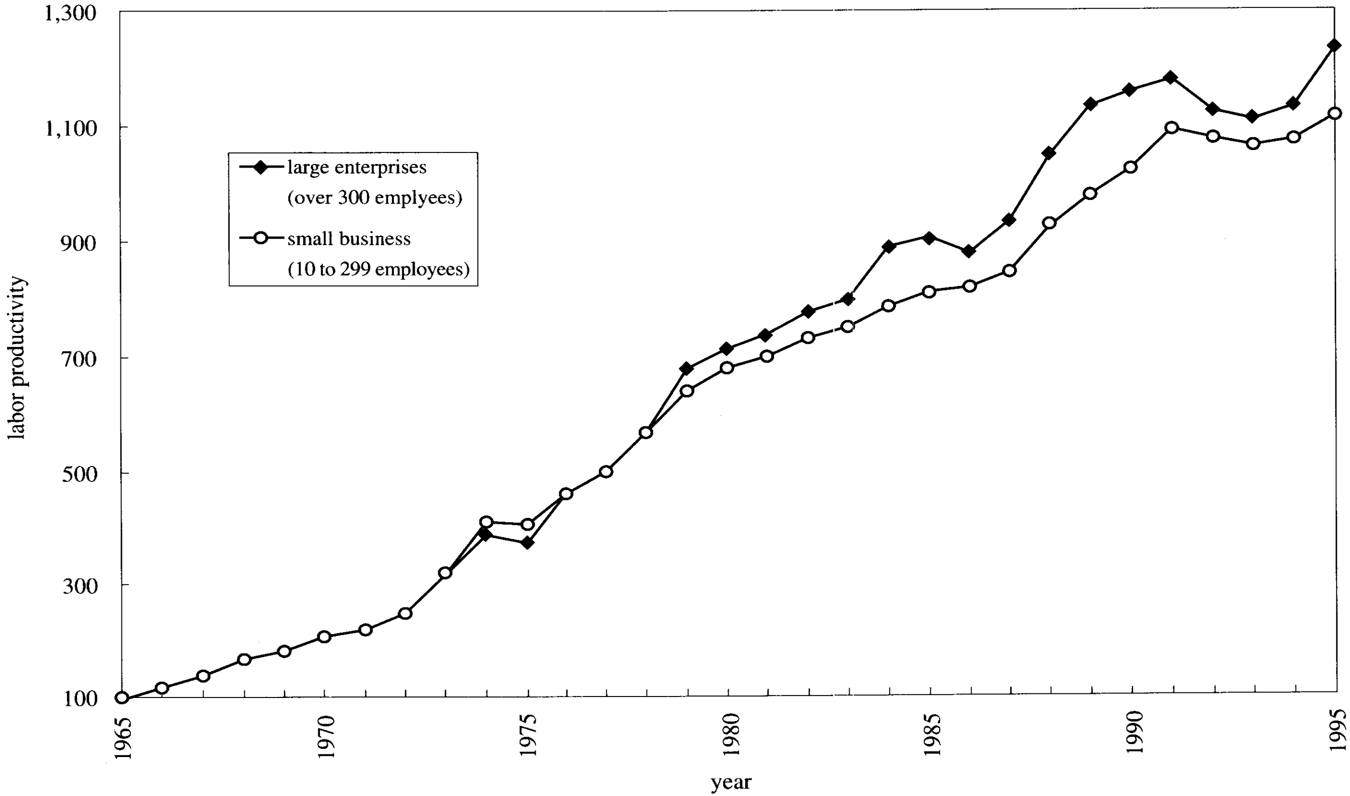
Toyota established Toyota Motor Credit in the US with stock capitalization of US$ 150 million and Toyota Finance Australia with A$3 million. Although the main business of these companies was retail financing, the head office in Japan planned to operate international fund raising and management through these internal financial centers, and to build up a system to swap currencies. To realize this objective, Toyota started Toyota Motor Finance B.V. in the Netherlands to manage loans to related companies. Meanwhile Nissan established Nissan Finance USA (NFUSA) in 1989, to operate fund raising and management, and currency control. A general head company for the Americas was then established in Los Angeles in 1990, Nissan North America Inc. (NNAI) (see Table 3.1). However, assembly makers which define strategies of internal capital management are restricted to the three listed above at present.

2.2. Investment Financing of the Auto Parts Industry

Government policies to promote the automobile industry in the 1950s and 1960s were much more significant to the parts industry than the assembly one, although they had same effects on the fiscal conditions of parts makers. In view of the financial assistance to promote equipment investments, the parts industry, mostly medium- and small-sized firms, benefited more from governmental supporting measures because their accessibility to private funds was weak. Particularly in the 1960s, 30 to 40 percent of total government financial loans for such small businesses were drawn by parts makers related to the automobile industry.[4]

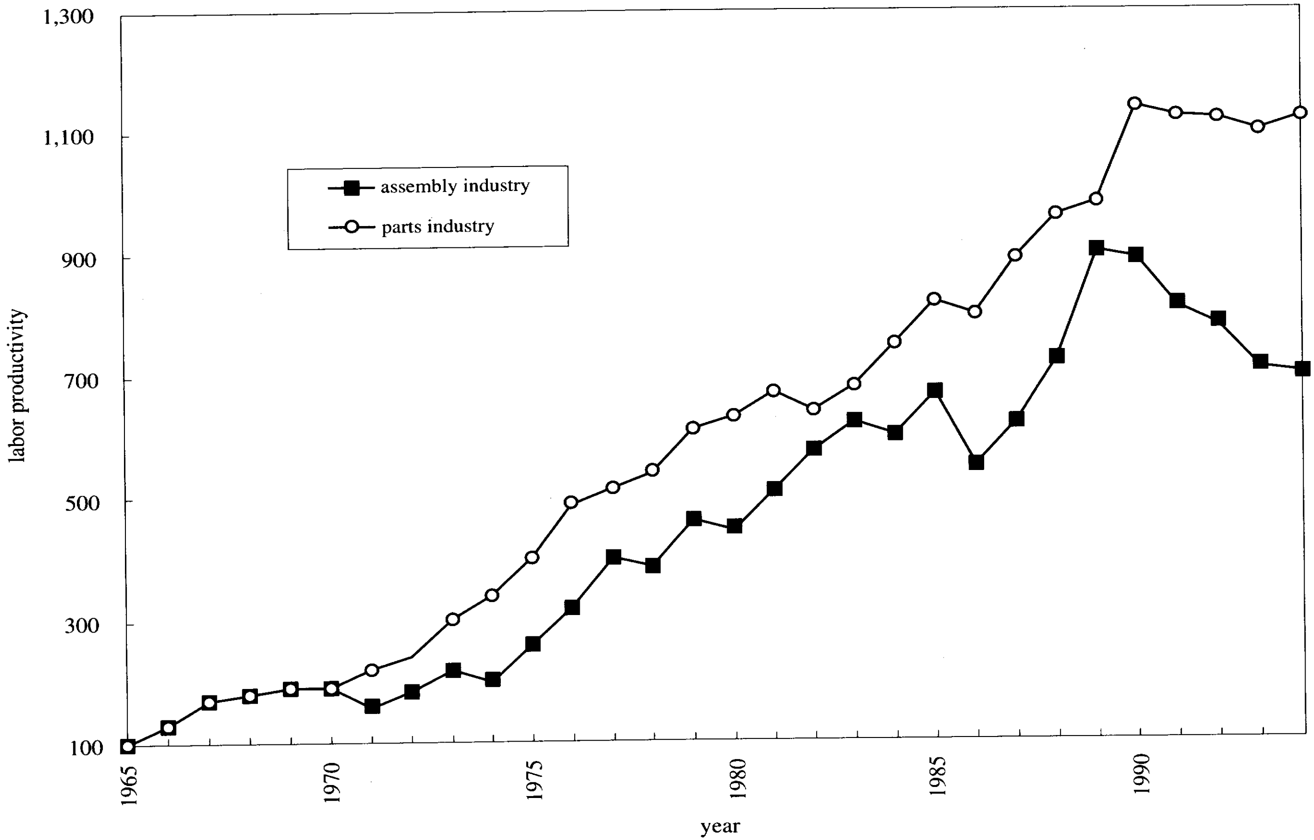
Political measures taken to support small business were more beneficial than those for big companies, although both sets of incentives were

Figure 3.3.1: Comparisons of Labor Productivity of Large Enterprises and Small Business (1965=100)



Note: Labor productivity = Total value added / Number of employee.
Source: MITI. *Kigyo Tokei Hyo* (Tables of Industrial Statistics).

Figure 3.3.2: Comparison of Labor Productivity of Assembly Industry and Auto Parts Industry (1965=100)



Note: Same as Figure 3.3.1.
Source: Same as Figure 3.3.1.

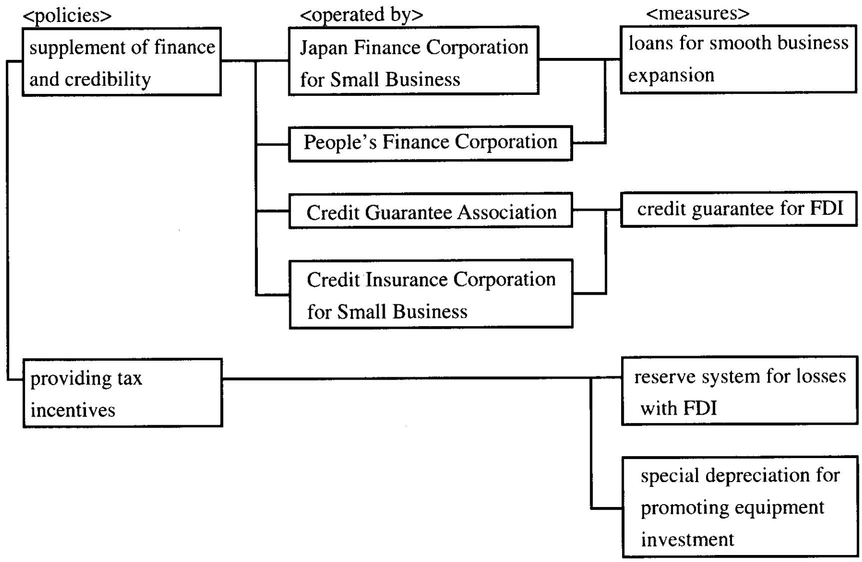
almost the same. The additional measures other than special loans from government financial institutions, and special deductions of machinery equipment, were: 1) reductions in corporate income tax for small businesses, 2) special deductions for small business, and 3) tariff exemptions on imported machinery. Even after tax incentives for big enterprises were abolished, those for small business were continued. This gave the parts industry the required incentives to introduce new foreign technology that lowered the internal production rate of auto parts, which had been relatively high in the early stage of its growth,[5] and preferentially allotted foreign currencies, and exempted them from tariffs. Also, special deductions directed the parts industry to accumulate internal reserve capital for equipment investment, by excepting it from profits.

As a result of these political, financing and tax incentives, the parts industry played an important role with its higher productivity and improved technology in the increasing competitiveness of the automobile industry, which was the leading sector for the industrial expansion of postwar Japan. Comparing changes in labor productivity between the assembly and parts industry, and large enterprises and small businesses of all manufacturing industries (see Figures 3.3.1 and 3.3.2), the parts industry has shown a greater increase in performance than the assembly makers, which is itself in contrast to other areas of industry where small businesses lag behind large enterprises.

Foreign operations of medium and small firms in the early stages follow two patterns: sole investment and joint investment with their assemblers. Even when small firms invest abroad independently, they tend to rely on banks, trading companies, and/or assembly makers in collecting information, developing local sales routes, re-exporting to Japan, and exporting to third countries, etc. The smaller the company, the more evident the tendency is. In the automobile industry, this occurred because parts makers' foreign operations were usually conducted to accompany assembly makers' business expansion, especially since the early 1980s, when assemblers started production in the US and Europe on a large scale.

In order to support these circumstances of small business, additional measures were introduced by governmental financial organizations. They were: 1) admitting to account internal reserves preparing for losses in FDI as deductible expenses, 2) special depreciation of equipment investment to subsidiaries or joint companies abroad, and 3) credit guarantee attached to private banks for loan application concerning FDI (see Figure

Figure 3.4: Financial and Tax Policies Related to FDI by Medium- and Small-Sized Business



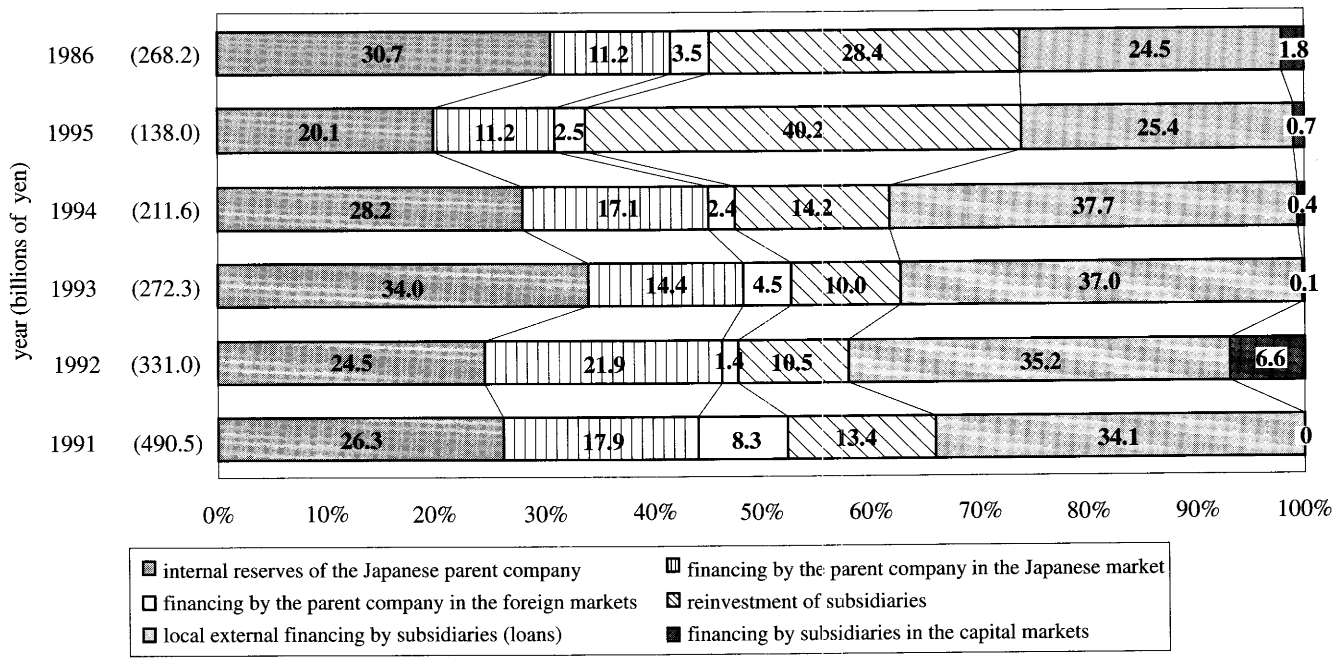
Source: Small and Medium Enterprise Agency ed. [1997b], p. 24, 36, 41, 47, 55, 81.

3.4). Furthermore, other organizations supporting FDI of small businesses, most of which are juridical persons under public laws, began to provide loans on condition of attached guarantees by banks. Autoparts makers conducted their FDI depending on these loans and schemes, as the shares in funding by such schemes concerning exports of machinery equipment to their subsidiaries or joint companies reached to around 40 percent.

2.3. Trends in FDI Finance in the 1990s

Above I cited the business expansion pattern of the automobile industry, however, to define the actual amount of FDI required by MNCs is not an easy task. For example, when a parent company issues bonds or increases its capital stock for investment or FDI, it sometimes converts some of that capital into its net worth. Another drawback is that efficient statistical data based on actual operations according to areas and industries has

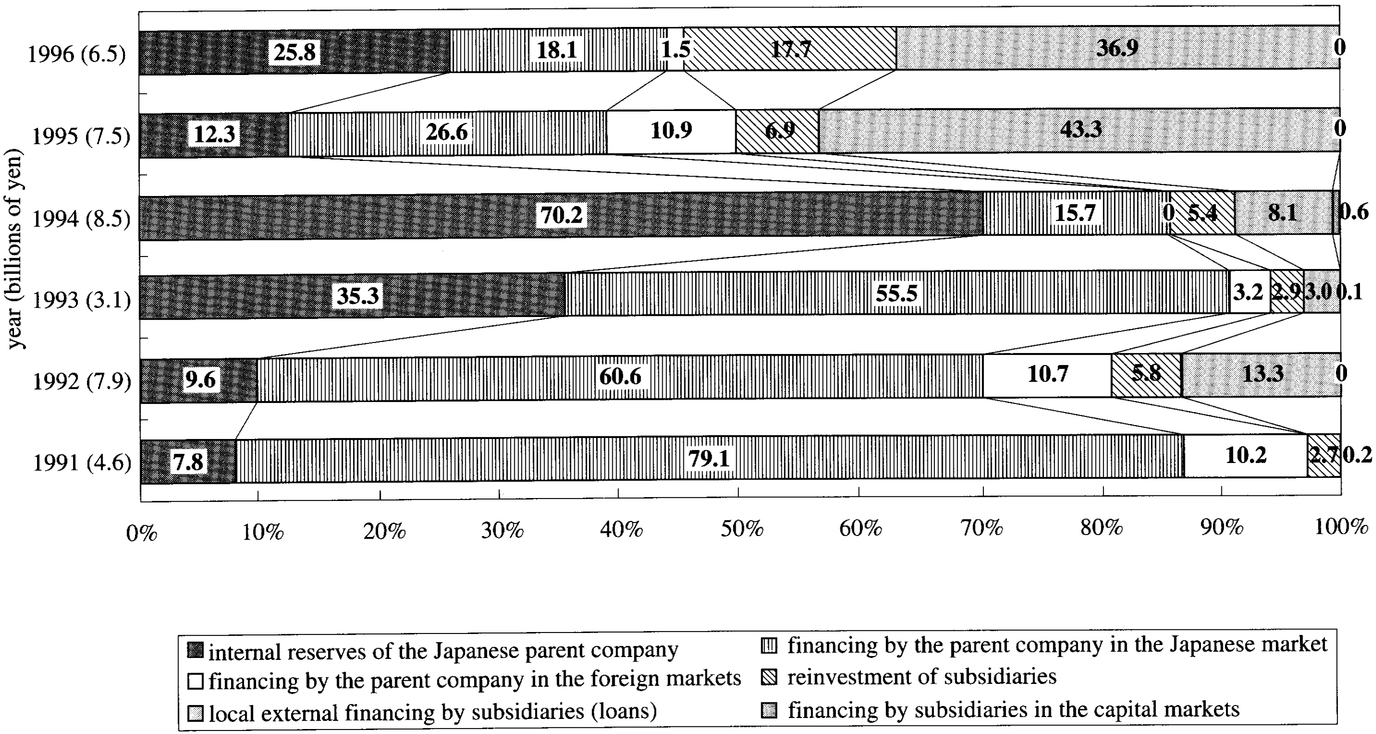
Figure 3.5.1: FDI Financing Measures of Large Enterprises



Note: The data includes companies with stock capitalization more than 1 billion yen.
Figures in parentheses are the total amount of FDI in each year.

Source: EXIM RIIID, *Kaigai-Toshi-Kenkyusyo-Ho* (Journal of Research Institute for Internatiol Investment and Development). various issues.

Figure 3.5.2: FDI Financing of Medium and Small Businesses



Note: The data includes companies with stock capitalization less than 1 billion. Figures in parentheses are the total amount of FDI in each year.
Source: Same as Figure 3.5.1.

not yet been accumulated enough, including three types of FDI in a broad sense; remittance from Japanese parent companies, reinvestment, and loans and bond issuing of local subsidiaries. For example, FDI data released by the Ministry of Finance only traces capital flows from Japan on the registration basis, excluding external financing by Japanese subsidiaries in the host countries.

On the other hand, actual financing by foreign subsidiaries is affected by each host country's situation. If the long-term credit market is under developed, or credibility of a subsidiary has not penetrated into foreign markets, MNCs ordinarily utilize credit guarantees from Japanese banks to take loans from local financial organizations, or convert nominal short-term credits into long-term commitments. Under these circumstances, the data deduced from questionnaires conducted by the Research Institute for International Investment and Development of the Export-Import Bank of Japan (EXIM RIIID) provides useful information. It defines FDI as the total of: 1) remittances from Japanese parent companies, 2) reinvestment from the subsidiaries' benefits, and 3) external financing by the subsidiaries in the host countries' domestic markets. Concerning Japanese automobile MNCs, which consider strategies on their business expansion covering their whole corporate group together with domestic and foreign related companies, remittances and financing by the parent enterprise is a mere aspect of their enormous FDI.

We can see clear differences in FDI financing between large enterprises and medium- and small-sized businesses, other than differences of accessibility to foreign capital markets. (see Figures 3.5.1 and 3.5.2) Firstly, in the early 1990s, small businesses invested abroad mostly depending on domestic financing by the parent companies in Japan, especially on those from loans and capital markets, in contrast large enterprises did so at around 50 percent.

Secondly, local external financing by medium and small businesses' subsidiaries increased remarkably from 1995, making up decreases of remittances from parent companies' internal reserves. Among large enterprises, external financing by subsidiaries is declining, covered by their reinvestments from the benefits. The year seems to be a turning point for small businesses to change the basis of their FDI financing from Japan to each host country.

3. PRIVATE BANKS' ACTIVITIES IN CORPORATE FINANCING

The role played by private banks, especially city banks, in the corporate financing of the automobile industry is divided into three: indirect finance cooperating with governmental financial organizations especially for small business, direct finance, and foreign branch activities in MNCs' host countries.

Table 3.2: Changes in Government Policies and Project Areas

Period	Government Policies	Project Areas
The late 1950s	Reconstruction and self-sufficiency of the economy	Electric power, coal mining, ocean shipping, iron and steel
The late 1950s-early 1960s	Encouragement of heavy and chemical industries	Machinery and electronic industries, synthetic fiber, petrochemicals
	Reduction of regional disparties	Regional development, private railroads
The late 1960s-early 1970s	Promotion of social development	Urban development, regional development
	Construction of a welfare society	Safety measures, pollution prevention, welfare facilities
	Development of domestic technology	Development of new technology, promotion of domestic computers
The late 1970s-early 1980s	Attainment of stable economic growth	Conservation of resources and energy, diversification of energy
	Improvement of living standards	Urban development, regional development, improvement of national living standards
The late 1980s-early 1990s	Construction of a creative and stable society	R&D in advanced technologies, information-related industries
	Achievement of peaceful and stable international relationships	Foreign direct investment in Japan
	Improvement of quality of life	Urban development, regional development
	Solution of global environmental problems	Conservation of environment, energy-saving measures

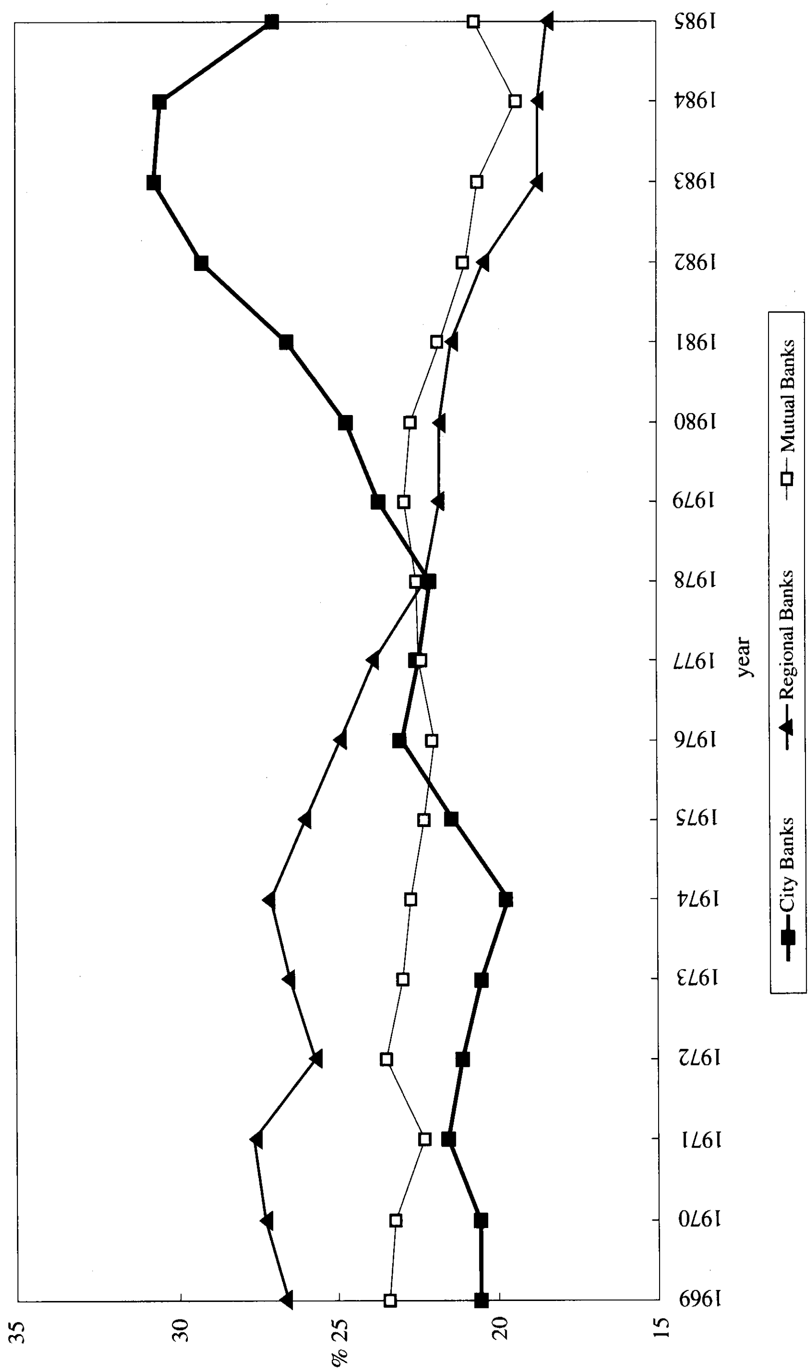
Source: Extracted from A Guide to JDB (The Japan Development Bank), http://www.jdb.go.jp

3.1. Indirect Financing: Cooperation with Government Financial Organizations

As was seen in subsection 2.1. that government financial organizations were established for the purposes of: 1) operating loans to companies which could not easily access private financial organizations because of a lack of credibility and collateral, or the scale of their project risk, 2) providing capital to the business sector in order to fulfill policy expectations and supplement the efforts of the private sector (see Table 3.2). Here, four organizations: the Japan Development Bank (JDB); the Export-Import Bank of Japan (EXIM Bank); the Japan Finance Corporation for Small Business (JFS); and the People's Finance Corporation (PFC), are the main bodies with responsibility to support corporate financing and FDI.[6] JDB and EXIM Bank mainly provide credits to large enterprises, and were the main credit supplier to the automobile industry in the pre- and early-stage of motorization. As seen in section 2.1., their activity gave rise to private banks' enormous lending to the industry.
On the contrary, credit schemes by JFS and PFC especially operating loans to small business are classified in two patterns: "direct loans" provided by themselves, and "agency loans" which are entrusted to private banks with most of the related operations, such as screening, agreement, and collection. These schemes set the same conditions to lender companies. Referring to changes in outstanding balance of agency loans according to banking business conditions, the share undertaken by city banks increased in the period of globalization of production, i.e., since the late 1970s (see Figure 3.6). According to Horiuchi [1988], intentions of JFS and PFC on private banks concerning the numbers and amounts of agency loans are indirect and not very influential, although they have nominal plans of shares and outstanding balances in accordance with the type of financial organization.[7] Thus, we can see city banks' eagerness to positively operate financing to small businesses by funding of agency loans, which were settled to raise small business financing to the preferable level, to make lending procedures easier for those companies, and functioned as an important measure of city banks' strategy to enlarge small business financing. For JFS and PFC, entrusting their credit operations to private banks was beneficial and convenient while they built branch networks nationwide from the early 1960s to the mid-1970s.

Such loans usually have attached credit guarantees by governmental organizations, and city banks fully utilize them both in agency loans and

Figure 3.6: Shares of Outstanding Balance in Agency Loans



Source: FCSB. *Chusho Kigyo Kin'yu Geppo* (FCSB Monthly Report). various issues.

loans provided by themselves. The Credit Guarantee Association provides corporate information to private banks as well as guarantees. When a lender company or its joint surety applying for a private loan is regarded as less credible or lacking sufficient collateral, the bank asks the necessary information and inquires if the company is able to obtain the guarantee of the association. In some cases, the company itself directly applies to the association for loans, in return the association introduces a private bank. After examining the application, the association makes a contract and guarantees the liability when the case is acceptable.

City banks needed such guarantees to keep their total outstanding balances from declining through financing for small businesses. As a result, the shares of small business credits in the city banks' total lending rose to nearly 60 percent in the late 1980s.

3.2. Direct Financing Market: Diversification of Corporate Finance in FDI in Consequence of Monetary Ease?

Besides indirect financing, under the assignee bank system maintained until 1993, private banks which operated collateral trust and soliciting assignment, participated in issue-planning, and led the bond floatation committee making regulations on issue standards.[8] They positively took part in managing bond-issuing markets. Assignee banks served concurrently in most cases as the issuing companies' main bank, therefore, corporate bonds were regarded as a modified means of bank loans. As the bond business needs to produce corporate information similar to screening of loan applications, assessing collateral and reviewing financial conditions, a representative assignee bank pursues these activities as the core of other assignee banks, that has the same meaning to hold the top share in loans for a company.

The largest absorbers of corporate bonds have been private banks, and Japan's Big Four securities companies have undertaken the underwriting operations. For private banks, the reason they put importance on taking on the assigning business was that it had a significance as "a crucial part of the main bank's original functions.[9] For example, when Toyota issued convertible US dollar bonds at the amount of 200 billion yen in 1987, its main banks Tokai and Mitsui took most of them.

Furthermore, in issuing shares, the room for lead managers of securities houses to exhibit their ability in sales, gathering information, and committing positively in issue planning as underwriters, had been limited. Although the trend that stock issuing at par increases relatively in the periods of monetary restraint when bank loans are not easily accessed, it has been observed that the lead managers' primary role in stockholder appointment was to liquidate lapsed shares at appointments. Under these circumstances, companies' main banks actually acted as the all-round advisor on corporate finance, including share-issuing.[10] Idei [1994] describes conditions in the Japanese equity and bond markets during this period:

> Considering the development of the Japanese equity market from the end of World War II to recent time, we could set two divided periods for convenience; until the mid-1970s, and afterwards. The former is the age of stock issuing at par and preferential allotments for stockholders, and the latter is that of stock issuing at market price. It is needless to say that the former system is for the corporate financing measures which coordinates with the traditional financial system with capital allotting on primary through collective, long-term relationships between companies and financial organizations. On the other hand, a basis of issuing at market price is to raise money from unspecified investors regardless of the relationship so far, therefore, this concept is essentially against the relationships in Japan. However, the Japanese financial system has skillfully incorporated this concept until recently with mechanisms of stable stockholders, reciprocal holdings, and the profit allotting rule of capital increase by new shares at market price, etc.[11]

In such a financial system, high profit-making is not necessarily the primary objective of equipment investments, especially that of FDI. As the Japanese auto industry's advancement abroad was initially intended to substitute exports from Japan, or to maintain market share, private banks provided abundant capital to the industry, because growth potential rather than profitability or expanding business scale was primary. In a matured industry, such as the Japanese automobile industry in the 1980s, the strategy of pushing small, fuel efficient cars, incorporating relatively advanced technology, was seen a successful approach to guarantee maintenance of a substantial share of the US and European auto markets. Therefore, stable stockholders, i.e., private banks, accepted issuing plans to double new stocks at market prices, although lower returns on equity (ROE) afterwards was predicted.[12] The Japanese automobile companies had further merits in competition with foreign automakers because the circumstances by which companies with low profitability could easily obtain capital had been build up in the direct-financing market in Japan (see Table 3.3).

Table 3.3: Comparisons of Corporate Profitability of the US and Japan[1)]

		Japan[2)]	US[3)]
1	$\frac{\text{operating profit} + \text{depreciations}}{\text{revenue}}$	5.0 (8.2)	13.5
2	operating income on sales	3.2 (5.2)	9.8
3	pretax income to sales	2.8 (4.6)	8.0
4	taxed income to sales	1.3 (2.2)	4.5
5	operating income on euqity capital	18.2 (18.5)	24.5
6	return on equity	8.5 (8.6)	13.9
7	rate of profit growth to a stock[4)]	6.2	12.5
8	rate of dividend growth to a stock[4)]	3.9	7.0

Notes: 1) Average of 1980–1988.
2) Average of NRI 350 (manufacturing and commerce industry).
3) Average of S&P Industrials.
4) Average of 1983–1988.
Source: Idei [1994], p. 122.

Thus in relations between private banks and securities companies, banks had a certain influential power to realize their intention through leading equity pricing even in the late 1980s, while their outstanding balance decreased and shifted to stock issuing. These relations were observed to be cooperative and supplementary rather than competitive and substitutive.[13] Here, we have to question the general belief that corporate financing for investments drastically shifted from city banks to securities companies during the process of monetary ease in the late 1980s, and that the relations between them turned out to be really competitive in the same period. Severe competition started in the mid-1990s when city banks' securities subsidiaries in the securities business made themselves proficient in both domestic and foreign equity markets.

3.3. Extension of Banking Business Abroad

Development of Japanese city banks' foreign bases of operations was actively broadened around 1970, when Japan's international balance of payment moved into the black, and they started to expand their business abroad. Their "international business" until then had mainly constituted foreign exchange related to trading, i.e., trades, settlements, the collections of import/export bills, and the provision of import credits. Although the situation was a far cry from building the global networks necessary to operate successfully in the international banking business, the city banks nonetheless multinationalized themselves rapidly, coping with globalization of production through financially supporting Japanese firms' business expansion to foreign countries.

The great expansion abroad of Japanese private banks started in 1969, because MOF eased regulations to prohibit setting foreign branches of authorized foreign exchange banks. At first, new bases were liaison offices. Although they did not operate loans or undertake other banking business, they worked as consultants for Japanese firms' FDI with related departments at the head offices in Japan. For instance, a Japanese autoparts maker which established a joint company in Asia was provided with advice till it signed contracts.[14] The number of foreign branches established by authorized foreign exchange banks was 53 from 1952, when the Bank of Tokyo (BOT) first opened its London branch in the postwar period, to 1968,[15] and the majority of those branches were BOT. However, during the decade from 1969 to 1978, foreign bases including branches, branch offices, liaison offices, and local corporations, increased to 388. Besides the increase of branches, the extension in the form of local corporations was remarkable. These corporations, in other words financial subsidiaries of banks, mainly worked as the banks' holding companies – buying foreign banks, investing in enterprises other than the banking sector, and undertaking financing business abroad for Japanese corporations. From 1970 to 1978, 61 private banks' local companies were established (see Table 3.4).

Table 3.4: Expansion of Japanese Private Banks Abroad from 1967 to 1978[1)]

	1967	68	69	70	71	72	73	74	75	76	77	78
Branch	2	1	1	1	4	15	10	14	3	6	11	11
Branch Office		3	3	1	1	1	1		1			
Local Company[2)]		1		2	4	5	12	15	2	8	6	6
Liaison Office		1	5	11	23	18	21	17	25	22	11	11
Total	2	6	9	15	32	39	44	46	31	36	28	28

Notes: 1) Branches and branch offices are counted when they start business. Local companies are when they are granted.
2) Local companies which are subscribed with more than 50 percent capital by Japanese private bank(s) are counted.

Source: International Finance Bureau, Ministry of Finance, *Annual Report of International Finance Bureau*, various issues.

As a matter of detail, only 23 among 113 authorized foreign exchange banks (as of 1978) had foreign offices and most of them were city banks. Seventy percent of the branches were established by the top six city banks and BOT, a specialized foreign exchange bank. Indeed, BOT accounted for about 30 percent of the total because of the nature of its business, therefore, it established foreign branch networks earlier than other city banks. Fujita et al. eds. [1979] pointed out that 74.43 percent of credits provided by BOT foreign branches were to other Japanese city banks, by contrast only 8.01 percent of credits were for its own related companies. This is evidence of BOT's role to avoid taking other private banks' risk while expanding their business by taking initiatives.[16]

City banks' efforts at consolidating global networks was not limited to the two international financial centers of London and New York, but included free trade bases in Singapore and Hong Kong, and tax haven countries in Central America and Europe. After the debt crisis in Mexico occurred in August 1982, banks' business expansion in developing countries stagnated until revitalized in the late 1980s by "the East Asian Miracle." The establishment of new production bases by Japanese automakers as host governments pursued policies to promote a national car followed (for example, in Indonesia). And, whereas a few assemblers started KD production in the area in the early 1970s, most of them constructed assembly plants in the mid-1990s. At the same time, city banks expanded their operation from liaison offices to line up varied services including offshore banking branches. The relationship between the liaison offices and local companies took off at the end of the 1980s and early 1990s, when two big assembly firms Matsuda and Honda, established joint ventures with local automakers and began production or announced their intention to do so.

Private banks' new bases of operation, including branches, liaison offices, and local companies, increased to 1,106 as of the end of 1994 from 913 in 1988. Among the newly established 193 bases, 111, constituting 58 percent of the total, are located in Asia, followed by 41 bases in the US and Canada (21%), and 37 in Europe (19%), which clearly shows their eagerness to consolidate their branch networks in Asia. However, 47 of the 111 new branches in that area are established in Hong Kong, because it has been defined as the most sophisticated financial center in Asia. Also, those located in Hong Kong, Singapore, and China constituted 70 percent of the total.

Characteristics of Japanese private banks' expansion in Asia has two patterns. Firstly, in most cases they have plural stations of different forms in an area, for example, combinations of a branch and a local company, or a liaison office and a financial subsidiary, etc. Those variations of business forms are the result of banks' efforts to deal with the diversified needs of Japanese subsidiaries within the limitations of interlocking in each country.

Secondly, they set up many offshore banking branches and companies in the area. In Asia, Hong Kong and Singapore have worked as important offshore banking markets so far, and the governments of Malaysia and Thailand started to develop financial markets to stimulate domestic economies at that time, which attracted Japanese banks to establish those kinds of foreign stations. The branches and companies coped with augmenting credit needs of Japanese subsidiaries for the medium- and long-term in the host currencies, through financing in foreign currencies in offshore markets and currency futures or swaps of derivatives.

4. PROBABLE MEASURES TO CONTRIBUTE TO INDUSTRIAL DEVELOPMENT OF HOST COUNTRIES

We cannot easily define what are effective measures for Japanese city banks to contribute to the enlargement of the credit market in developing countries and cooperating with their industrial development, because conditions in each country are different. However, at present, foreign bases of Japanese city banks are facing the necessity to localize themselves by financing domestic companies, although their customers are usually large ones who can reach international markets and issue samurai bonds or floating rate notes.[17]

In this section, two programs, one in the host country and the other in Japan, are mentioned as possibilities for Japanese private banks to provide funds to local companies in host countries, in accordance with their primary motive for operating abroad, i.e., financially supporting Japanese MNCs. In order to realize it, collecting information about local firms will be inevitable through local financial organizations and Japanese contractors.

4.1. The Vender Development Program in Malaysia

The Malaysian government has the Vender Development Program (VDP). The Proton Component Scheme (PCS), the predecessor of the VDP, was started in 1988, setting Proton Co. as the center of the scheme.

In the PCS, Proton Co. founded new vender companies, and primarily purchased their products. On the other hand, the Malaysian government provided preferential loans for their equipment investments. Later, a Malaysian telecommunication-equipment company and a Japanese home-electronics company joined the PCS, which was amended and altered to the VDP in April, 1993.

The new scheme is in the style of tripartite agreement among the Malaysian government, financial organizations, and big enterprises (anchor companies); anchor companies (domestic or foreign) seek and register new subcontractors (vender companies), and foster them by ordering production of parts and technological training. Also, financial organizations, together with anchor companies, cooperate with venders in crediting. These financial organizations are private banks, therefore, no guidance policy finance, for example supplying interest, is provided. However, venders registered in the VDP increase their credibility, as they receive lower interest rates on loans for equipment investments than non-registered firms, because banks regard them as supported by anchor companies with various instructions.

In the VDP, the majority of anchor companies are Japanese subsidiaries.[18] The program works well as the measures for purchasing domestic parts by MNCs, and Japanese subsidiaries' contribution seems to be significant in view of cooperating to the host government's policies of fostering medium- and small-sized firms.

4.2. Japanese Expert Service Abroad Programs

Japanese companies, mainly in machinery industries, have utilized some programs provided by the Japan Overseas Development Corporation (JODC) and the Association for Overseas Technical Support (AOTS) to promote local subcontractors. JODC operates the Japanese Experts Service Abroad Program, that dispatches registered Japanese professionals for three months to three years to give technical and managerial guidance and training to local employees in developing countries. Most of the experts are chief managers of production plants. What is worthy noting is that this scheme requires for applicant companies not to have received any investment or technical support from Japanese organizations, or if any, less than 50 percent of the total amount invested (see Table 3.5). JODC bears three-fourths of the expenses, but host companies in developing countries sometimes cannot afford the remaining one-fourth. For that reason, Japanese subsidiaries provide technical and managerial sup-

Table 3.5: Schemes of JODC Expert Service Abroad

	Requirement for Application	Cost Sharing
TYPE-I	1. The applicant shall be private business (including a public corporation) requiring technical guidance by JODC expert(s) in a developing country. 2. No agreement shall have been made for the dispatch of technical personnel on the basis of a technical service contract or plant export contract between the applicant and a Japanese business. 3. No. investment or commitment there of shall exist between the applicant and a Japanese business.	Three-fourths of the costs in dispatching expert(s) shall be borne by JODC, and the remaining one-fourth shall be borne in local currency, etc., by the recipient business.
TYPE-II	1. (Same as TYPE-I) 2. (Same as TYPE-I) 3. If an investment is made in the applicant by a Japanese organization, the ratio of such investment shall be less than 50% in principle.	Three-eights each of the costs in dispatching expert(s) shall be borne by JODC and the Japanese business to render cooperation, while the remaining two-eights shall be borne in local currency, etc., by the recipient business.
TYPE-III	1. (Same as TYPE-I) 2. (Same as TYPE-I) 3. No investment or commitment there of shall exist between the applicant and a Japanese business. 4. The applicant shall have less than two hundred (200) employees, as a general rule.	The recipient business shall offer local accommodation facilities (hotel, house, flat) to JODC expert(s) free of charge, and shall pay, mainly in the local currency, a fixed amount for local business expenses and the the incurred costs of guidance materials/equipment. JODC shall bear all other costs.

Source: JODC, *Introduction to JODC Expert Service Abroad (JESA) Program* (a leaflet, as of December, 1996).

port through JODC experts to their subcontractors, bearing the expense share originally alloted to the host companies.

5. CONCLUDING REMARKS

As described above, the trinity of policy finance, private banks' credit, and tax incentives, has been absolutely instrumental for the Japanese automobile industry from the viewpoint of its development and providing domestic investment and FDI financing. Companies invested in equipment through special credits under the Temporary Measure Law of Promoting Machinery Industries and increased loans from private banks inspired by the law, and utilized the tax preferential to accumulate their own capital to expand FDI. However, we should not consider that industrial development could be accomplished with cooperated financing by governmental institutions, including financial ones and private banks. In manufacturing industries at present, especially the automobile industry with a matured global market, not much could be deducted from the motorization in Japan of thirty years ago, although it could be regarded as a typical pattern of industrial development. We should not neglect the background at that time, the existence of a niche market for small cars and Japan's comparative advantage because of limitations from its circumstances of road transportation and energy resources. These factors enabled the industry to store up benefits by improving production potential, raising its technical standards and international competitiveness, leading to a greater share in the US and European markets and expanding its business. City banks have been at the center as suppliers of investible funds, both in indirect and direct financial markets.

On the other hand, as a measure of corporate finance and a financial institution, inter-supplement relationships between governmental and private financial organizations, led by city banks, deserves attention. Chiefly in the credit schemes for small businesses, where agency loans and the Credit Guarantee Association complement private banks' credit. Furthermore, to FDI related financing, private banks attach their guarantee to other organizations' loan application. Building functional networks among financial organizations is a crucial factor to consolidate subcontractors' financial basis of investment. Efforts by financial institutions to ease difficulties in contracting loans to small businesses can be remarkable, as the Japanese auto parts industry has shown by its higher improvement in productivity over the assemble industry.

Notes

1. The 1947 permission to produce cars did not give complete authority. It limited numbers of unit production per year: fifty for large-sized (over 1,500cc), and three hundred for small-sized (under 1,500cc). The limitation was entirely relieved in 1949.

2. For details about automakers' subcontractor association and their activities, see Sako [1996].

3. Other than the automobile industry, Marubeni Co., Ltd. (a *sogo shosha*), and Nippon Life Insurance announced they would introduce the "internal banking system" in two or three years, which would operate currency transfer and capital management completely in their own business groups.

4. Itami [1994], p. 176.

5. At present, the rate of internal parts production by assembly makers is between 70 to 80 percent.

6. The government financial organizations are: JDB, EXIM Bank, SBFC, Small Business Insurance Corporation (SBIC), Agriculture, Forestry and Fisheries Finance Corporation, Housing Loan Corporation, Okinawa Development Finance Corporation, Central Bank of Commercial and Industrial Cooperatives (a special corporation), Hokkaido-Tohoku Development Finance Public Corporation, Environment and Hygiene Finance Corporation.

7. Horiuchi [1988], p. 167-168.

8. In the regulation, "the principle of secured issuing," "financial and scale conditions for the issuing approval," "limits to the amount of issuing," "restrictions of variety of maturity structures," etc., were settled.

9. Tsuda [1995], p. 160.

10. Plant, et al. eds. [1996], p. 180.

11. Idei [1994], p. 188, translation into English by the author of this paper.

12. Lower ROE usually causes a decrease in stock prices, but in the financial system described above, stock prices with low profitability were evaluated higher by growth potential, given prominence by the "relationship" shareholders.

13. For detail analysis utilizing incomplete information paradigm, see Plant et al. eds. [1996], p. 130-152, chapter 7. As a result of establishment of the cartel among banks and securities companies, cases where assignment fees on the scale of issuing 10 billion yen in the Japanese bond market were over ten times as high as those usual in Eurobond market, were reported.

14. Fuji Bank [1980], p. 576.

15. They were: 28 of BOT, 6 of Mitsui Bank, 3 for each of Fuji, Sumitomo, Mitsubishi, and Dai-Ichi Kangyo Bank, 1 for each of Tokai, Daiwa, and Taiyo-Kobe Bank. (Names of banks are at that time.)

16. Fujita, et al. eds. [1979], p. 95.

17. This situation has become ambivalent in Southeast and East Asian countries such as Indonesia, Malaysia, and Korea because of the currency crises that started at the end of 1997. Private banks have to review their business strategy and branch networks according to their own credibility and financial structures.

18. As of October 1994, the number of anchor companies is forty, and that of vender companies is fifty-nine.

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